



Alliance of Western Milk Producers

Representing California's dairy cooperatives and their producer-owners since 1991

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April 27, 2006

David Ikari, Chief
Dairy Marketing Branch
California Department of Food and Agriculture
1220 N Street
Sacramento, California 95814

Re: Alternative Proposal for June 1, 2006, Hearing to Consider Changes to the California Milk Marketing Stabilization Plans' Class 4b Pricing Provisions

Dear Mr. Ikari:

This alternative proposal for changes to the both the Northern and Southern stabilization plans is being submitted by the Alliance of Western Milk Producers on behalf of its member cooperatives: California Dairies Inc., Dairy Farmers of America and Humboldt Creamery. Together these cooperatives represent approximately 60 percent of the milk producers in California and more than 60 percent of the milk produced in California. It should also be pointed out that two of the three have ownership interests in cheese manufacturing facilities. This proposal has been unanimously approved by the Alliance Board of Directors.

The basic tenant of the Alliance's approach to manufacturing allowances is that any changes to them should be cost justified. That is the principle upon which this alternative proposal is based.

For the most part, the costs reflected in the manufacturing cost studies that the Department does, on a regular basis, capture a certain time frame. While the Department has made strides in getting the data as current as possible, it is really playing catch up. No matter how current the data collected is, the very nature of the pricing system is such that manufacturing costs can never actually be current. For most of the costs in manufacturing cheese, butter and nonfat powder, that is not a major problem because those costs change annually or over an even longer period of time.

However, in recent times there is one cost area that has become an issue for manufacturing plants and producers – the cost of energy. The cost of energy, particularly natural gas, has fluctuated dramatically in recent times. Unless a new direction is taken to account for these fluctuations in energy costs, any decision the Department makes using a specific time frame will create winners and losers. Depending on what energy costs were at the time of the cost study, either dairy farmers or manufacturers would be losers going forward.

Therefore, first and foremost, the Alliance is proposing an indexing system to adjust energy costs in the manufacturing allowances for Class 4a and Class 4b on a month-to-month basis. Even though California hearings are usually held on a timely basis, realistically, it takes at least four months from petition to decision and that time frame can be very costly to the losers whether they are producers or manufacturers.

The Alliance proposes that Class 4a and Class 4b make allowances be adjusted monthly by multiplying the unadjusted natural gas cost in the manufacturing cost study data by the monthly factor arrived at by dividing the current year's monthly United States Natural Gas Industrial Price as published by the U.S. Energy Information Administration by the United States Natural Gas Industrial Price for the same month in the previous year. (See below.)

	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>	<u>May</u>	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>	<u>Nov</u>	<u>Dec</u>
2005	6.97	7.07	7.04	7.62	7.09	6.84	7.34	7.90	10.09	11.88	11.92	10.90
2006	10.86											
Multiplier	1.56											

In addition, the Alliance alternative proposal modifies the 4b formula as follows:

1. The make allowances used in the Class 4b formula for cheese would be \$0.1832 per pound and for butter \$0.1657 per pound.
2. The California price adjuster for cheese and butter would be the most recent 12-month weighted average, minus \$0.0175 per pound for cheese and \$0.0270 for butter.
3. The other solids make allowance would increase to \$0.2106 per pound of dry whey. However, it should be snubbed so that the value of other solids in the formula cannot be less than zero.
4. The commodity values used in the to calculate the Class 4a and Class 4b prices will be snubbed at the CCC block Cheddar cheese, butter and nonfat dry milk powder purchase prices.

The Alliance continues to question the California dry whey manufacturing cost data, especially in light of the testimony of USDA's Dr. Charles Ling at the National Federal Orders Hearing in January 2006. The Ling dry whey data shows a weighted average manufacturing cost of \$0.1141 per pound, far lower than the CDFA data. Therefore, the Alliance proposal adjusts the dry whey make allowance using the same methodology it used to determine the cheese and butter make allowance adjustments, but calculated for the nonfat dry milk.

The Alliance proposal includes snubbing the dry whey make allowance so that it cannot be higher than the price at which dry whey is sold. Unless the dry whey make allowance is snubbed, producers are subsidizing a small minority of cheese processors who choose to dry whey when they can't sell it to whey protein concentrate processors.

Attached is a stabilization plan modified to reflect the changes proposed by the Alliance. If there are any questions, please don't hesitate to call.

Sincerely,


James E. Tillison, CEO

Stabilization Plan Changes

(D) The minimum prices to be paid for components used for Class 4a shall be computed as follows:

- (1) For all milk fat, not less than the price per pound computed by the formula using the butter price, less an f.o.b. California price adjuster of ~~two and eighty five hundredths cents (\$0.0285)~~ two and seventy hundredths cents (\$0.0270) less a manufacturing cost allowance of ~~fifteen and six tenths cents (\$0.156)~~ sixteen and fifty-seven hundredths cents plus the result of multiplying the natural gas cost portion of the manufacturing cost allowance by the monthly factor arrived at by dividing the current year's monthly United States Natural Gas Industrial Price as published by the U.S. Energy Information Administration by the United States Natural Gas Industrial Price for the same month in the previous year and the result multiplied by a yield factor of one and two-tenths (1.2).
- (2) For all milk solids-not-fat, not less than the price per pound computed by the formula using the nonfat dry milk price, less a manufacturing cost allowance of ~~fifteen and two tenths cents (\$0.152)~~ sixteen and twenty-six hundredths cents (\$0.1626) plus the result of multiplying the natural gas cost portion of the manufacturing cost allowance by the monthly factor arrived at by dividing the current year's monthly United States Natural Gas Industrial Price as published by the U.S. Energy Information Administration by the United States Natural Gas Industrial Price for the same month in the previous year multiplied by a yield factor of one (1.0).
- (3) The butter prices used in calculations pursuant to this Paragraph shall be the simple average of the Grade AA butter price quotations for the last significant trading action for sale, offer or bid at the Chicago Mercantile Exchange falling between the period beginning the 26th day of the previous month and concluding the 25th day of the current month, but in no case shall be less than the United States Department of Agriculture Commodity Credit Corporation purchase price for butter.
- (4) The nonfat dry milk prices used in calculations pursuant to this Paragraph shall be the weighted average price per pound for all Grade A and extra grade nonfat dry milk for human consumption sold f.o.b. California manufacturing plants for the period beginning the 26th day of the previous month and concluding the 25th day of the current month, as reported by the California Department of Food and Agriculture for the month, but in no case shall be less than the United States Department of Agriculture Commodity Credit Corporation purchase price for nonfat dry milk powder.
- (5) In the event that the Chicago Mercantile Exchange Grade AA butter price is not available to calculate the current Class 4a fat price, pursuant to Subparagraph (D)(1), then used in its place shall be the Chicago Mercantile Exchange Grade AA butter price used in the prior month's calculation of the Class 4a fat price. All other Paragraphs that use the Class 4a fat price shall operate as if the price had been established pursuant to Subparagraph (D)(1).
- (6) In the event that the California weighted average nonfat dry milk price is not available to calculate the current Class 4a solids-not-fat component price, pursuant to Subparagraph (D)(2), then used in its place shall be the California weighted average nonfat dry milk price used in the prior month's calculation of the Class 4a solids notfat price. All other Paragraphs that use the

Class 4a solids-not-fat price shall operate as if the solids-not-fat price had been established pursuant to Subparagraph (D)(2).

(E) The minimum prices to be paid for components used for Class 4b shall be computed as follows:

- (1) The Cheese hundredweight price shall be the price per hundredweight computed by the sum of the following:
 - (a) The price per hundredweight computed by the formula using the Cheddar cheese price, less an f.o.b. California price adjuster of ~~two and ninety hundredths cents (\$0.0290)~~ one and seventy-five hundredths cents (\$0.0175), less a Cheddar cheese manufacturing cost allowance of ~~seventeen and one tenth cents (\$0.171)~~ eighteen and thirty-two hundredths cents (\$0.1832) plus the result of multiplying the natural gas cost portion of the manufacturing cost allowance by the monthly factor arrived at by dividing the current year's monthly United States Natural Gas Industrial Price as published by the U.S. Energy Information Administration by the United States Natural Gas Industrial Price for the same month in the previous year, all multiplied by a yield factor of ten and two-tenths (10.2).
 - (b) The price per hundredweight computed by the formula using the butter price, less a manufacturing cost allowance of ~~fifteen and six tenths cents (\$0.156)~~ sixteen and fifty-seven hundredths cents, less ten cents (\$0.10), all multiplied by a yield factor of twenty-seven-hundredths (0.27).
 - (c) The price per hundredweight computed by the formula using the dry whey price, less a manufacturing cost allowance of ~~twenty cents (\$0.20)~~ twenty-one and six hundredths cents (\$0.2106) plus the result of multiplying the natural gas cost portion of the manufacturing cost allowance by the monthly factor arrived at by dividing the current year's monthly United States Natural Gas Industrial Price as published by the U.S. Energy Information Administration by the United States Natural Gas Industrial Price for the same month in the previous year, the sum of which cannot be less than zero cents (\$0.0000), all multiplied by a yield factor of 5.8.
- (2) For all milk fat, not less than the price per pound computed pursuant to Subparagraph (D)(1) of this Section.
- (3) For all milk solids-not-fat, not less than the price per pound computed by the formula using the Cheese hundredweight price established pursuant to Subparagraph (E)(1) less the product of three and seventy-two hundredths (3.72) multiplied by the Class 4b fat price established pursuant to Subparagraph (E)(2), all divided by eight and eighty hundredths (8.80).
- (4) The Cheddar cheese prices used in calculations pursuant this Paragraph shall be the simple average of the 40 pound block Cheddar cheese price quotations for the last significant trading action for sale, offer or bid at the Chicago Mercantile Exchange falling between the period beginning the 26th day of the previous month and concluding the 25th day of the current month, but in no case shall be less than the United States Department of Agriculture Commodity Credit Corporation purchase price for 40 pound block cheddar cheese.
- (5) The butter prices used in calculations pursuant this Paragraph shall be the simple average of the Grade AA butter price quotations for the last significant trading action for sale, offer or bid at the

Chicago Mercantile Exchange falling between the period beginning the 26th day of the previous month and concluding the 25th day of the current month, but in no case shall be less than the United States Department of Agriculture Commodity Credit Corporation purchase price for butter.

- (6) The dry whey prices used in calculations pursuant to this Paragraph shall be the simple average of the Dry Whey – West Mostly prices as published in Dairy Market News between the period beginning the 26th day of the previous month and concluding the 25th day of the current month.
- (7) In the event the Chicago Mercantile Exchange 40 pound block Cheddar cheese price is not available to calculate the Cheese hundredweight price, pursuant to Subparagraph (E)(1), then used in its place shall be the cheese price used in the prior month's calculation of the Cheese hundredweight price.
- (8) In the event that the Chicago Mercantile Exchange Grade AA butter price is not available to calculate the Cheese hundredweight price, pursuant to Subparagraph (E)(1), then used in its place shall be the Grade AA butter price used in the prior month's calculation of the Cheese hundredweight price.
- (9) In the event that the Dry Whey – West Mostly price is not available to calculate the Cheese hundredweight price, pursuant to Subparagraph (E)(1), then used in its place shall be the Dry Whey – West Mostly price used in the prior month's calculation of the Cheese hundredweight price.
- (F) The minimum prices to be paid pursuant to Paragraph (A) of this section shall be computed by the Dairy Marketing Branch and furnished to handlers not less than ten days prior to the effective date of each price change.
- (G) The minimum prices to be paid pursuant to Paragraphs (B), (C), (D), and (E) of this section will be computed by the Dairy Marketing Branch and furnished to handlers each month.